



Nippon **india** Mutual Fund

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Fixed Income

Market Outlook

September 2026



Fixed Income Market Update and Outlook

Market Update

Robust Growth, FCNR Deposit, Hawkish RBI Minutes

Aug'26 continued to witness extended geo-political pressures and elevated oil prices. While global growth continued to remain resilient, inflation is now on global central banker's radar.

Indian economy continued to grow at buoyant 7.8% y/y amidst war and deficient rains backdrop. Monsoon remained deficient in Aug'26, with the cumulative deficit at ~14% by Aug'26 end. Jul'26 inflation stood around RBI's medium-term target. RBI's FX measures (FCNR deposits) received record inflows, thereby improving INR and BoP outlook, increasing deposit flows and record system and durable liquidity.

India

Economic Growth:

1Q (Apr-Jun) FY27 GDP (Gross Domestic Product) print grew robustly at 7.8% y/y (higher than market expectations) driven by buoyant private consumption, capex and exports growth. 4Q FY26 GDP print was revised upward to 8.6%y/y (Prior estimate: 7.8%y/y). From supply side, manufacturing, construction and services grew robustly, driving GVA (Gross Value Added) to grow at 8.2%y/y. This growth was achieved amidst the peak war concerns and monsoon deficit (El Nino).

Inflation:

Jul'26 CPI inflation increased marginally to 4.45%y/y (Jun 2026: 4.38%y/y; Consensus: 4.4%y/y). This was primarily due to favourable base effect. The rise in monthly print (~1% m/m) was driven mainly by pick-up in food prices (seasonality), education & restaurant prices. Core inflation (excludes food, fuel, petrol and diesel) rose to 3.9%y/y (Jun 2026: 3.9% y/y; Avg Apr-Jul 2026 ~3.8% y/y). Core-core inflation (excludes petrol, diesel gold) rose to 2.6% y/y (Jun 2026: 2.5%; Avg Apr-Jul 2026 ~2.4% y/y).

Balance of Payment:

1Q FY27 (Apr-Jun) was modest at 0.5% of GDP (1Q FY26: 0.4%) high trade deficit. Robust net services exports and NRI remittances helped in reducing current account deficit (CAD). On the other hand, the capital flows were negative due to outflows from FPIs and other capital amidst the peak geopolitical related market volatility. As a result, 1Q BoP was negative at Rs. 8 bn, despite muted CAD print.

Foreign Trade:

In Jul'26, the trade deficit continued to remain elevated at US\$32 bn on robust exports and higher double digit imports growth (oil & core imports). During Apr-July 2026, both exports (oil & core) and imports (oil, gold and core) grew double digit on the annual basis. During similar period, the net services exports were modest at ~9%/y (Previous year similar period: ~18%/y).

FCNR Deposit led FX Flows:

RBI garnered US\$136 bn during Jun-Aug through swap window for NRI deposit led FX flows. This has led to sharp rise in deposit, jump in system and durable liquidity and improvement in INR and BoP outlook.

Fiscal:

Apr-July 2026 Fiscal deficit stood at modest ~27% of BE FY27 (~ Previous year lvs). This was primarily due to robust receipts (net tax, non-debt capital receipts). The core revenue expenditure (excluding interest payments) and capex was buoyant indicating front-loading of the expenditure. On sources of funding fiscal deficit, YTD small savings and Others' collections continued to remain robust. The govt was holding robust cash balances at July end indicating comfortable liquidity position.

Liquidity:

Monthly average system liquidity in August 2026 improved to ~Rs. 3.7 trn (1.3% of NDTL) driven by record flows in FCNR deposits. August liquidity was higher than average Jun/July liquidity (~Rs.1 trn). Core Liquidity by mid-Aug improved to ~Rs.8 trn (~Rs. 6.7 trn at Jun end) and expected to have had improved further by August end. Note, the RBI has garnered robust FX flows (~US\$136 bn) through FX measures (NRI deposits, ECB etc) since June Policy.

Foreign Flows:

FPI flows moderated to ~ US\$2.6 bn from US\$4 bn in July. That said, FPI has witnessed outflows from March through May 2026 (~ve US\$24 bn) driven by war concerns. YTD FPI outflows in the calendar year 2026 stood at US\$16 bn driven primarily by equity (US\$24 bn) as against overall outflow of US\$12bn in CY25. Debt FPI flows have been robust since June (~US\$8 bn).

Currency:

After depreciating by ~0.9% in Jun, INR appreciated by 0.4% m/m in August 2026 on robust FX flows (deposits, equity) and dollar depreciation of. During the month, INR stood on an average 95.47 against dollar (July 2026: 95.82). YTD Calendar year 2026 INR has depreciated by ~6% driven primarily by the sharp rise in geopolitical concerns.

Yield Levels & Spreads:

G-sec yield was range-bound in first fortnight of August and hardened in second half of the month on hawkish RBI minute, high crude prices, hardening global bond yields and hawkish global central bankers (US Fed Chairman Warsh comments at Jackson Hole). 10 yr G-sec yields moved in the range of 6.76-6.95% (July range: 6.69%-6.84%). It closed the month higher at 6.95% (Jun 2026: 6.75%, Jul 2026: 6.83%).

Taking cues from G-sec, the SGS (State Govt Securities) yields moved up during the month, while the monthly primary supply remained robust (~Rs. 0.8 trn). 10-year SDLs moved in the range of 7.40%-7.64% (Prior month: 7.38%-7.47%). It closed the month higher at 7.64% (Jun 2026: 7.40%; July 2026: 7.45%). The average spread between 10 yr SDL over G-sec stood at 63 bps during the month (Jun 2026: 70 bps; July 2026: 66 bps).

Similarly, 10-year AAA bond yields moved in the range of 7.45%-7.77% (Prior month: 7.35%-7.52%) and closed the month higher at 7.77% (June 2026: 7.38%; July 2026: 7.48%).



Financial Markets:

US Federal Reserve Chairperson's hawkish statements at Jackson Hole symposium and inflation concerns raised in Fed Policy minutes indicated that inflation will be key determinant in policymaking, going forward. The UST yield continued to remain elevated during Aug'26 on inflation outlook, fiscal concern and rate hike expectations. 10 yr UST moved in the range of 4.63-4.75 (July 2026: 4.48-4.75%) and close the month at 4.75% (Jun 2026: 4.44%; July 2026: 4.75%).

In Aug'26 DXY depreciated by avg ~0.6% m/m (Jul 2026: +ve 1.6%) on higher USTs, fiscal & inflation concerns and high crude prices. Calendar year till date the DXY has appreciated by ~1%.

After declining for three consecutive months, the crude oil appreciated by ~9% m/m in Aug'26 (July 2026: -ve ~2% m/m). The average crude oil declined to ~US\$91/ barrel (bbl) (June 2026: 84/bbl).

Market View

- » Higher than expected robust Foreign Currency Non-Resident (FCNR) deposits led Foreign Exchange (FX) flows have helped in improving US\$ liquidity, FX reserves, INR and Balance of Payment (BoP) outlook. This has also led to huge deposit mobilisation and record banking system and durable liquidity. As on Sep 3, 2026 the banking system liquidity surged to Rs. 10.5 trn (3.7% of NDTL). Against the backdrop of abundant liquidity, the RBI might consider a combination of short-term and long-term measures to reduce excess liquidity from the banking system.
- » While geo-political environment continues to remain volatile, the domestic macro-stability outlook (growth, fiscal, external sector) has improved in recent months. That said, deficient monsoon, evolution of El Nino and crude may continue to remain key risk to outlook.
- » While the early Aug'26 monetary policy was dovish, the minutes for the same were broadly hawkish, with Monetary Policy Committee (MPC) members asserting the need to recalibrate the policy rates, while focusing on the evolving inflation trajectory (whether the inflation is getting broad-based etc). The timing of the next rate hike may likely depend on the evolving geopolitical dynamics, inflation outlook and global Central Bankers rate hike cycle.

Common Source:

RBI, CSO, FAO, CEIC, NSO, US Federal Reserve, US Treasury department, Commerce Ministry of India, Finance Ministry of India, Mospi, NIMF Internal Research.

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